

FHA Solvency Act of 2013

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Mr. JOHNSON, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

The Committee on Banking, Housing, and Urban Affairs, having had under consideration S. 1376, a bill to improve the Federal Housing Administration (FHA) and to ensure the solvency of the Mutual Mortgage Insurance (MMI) Fund, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

INTRODUCTION

On July 31, 2013, the Senate Committee on Banking, Housing, and Urban Affairs considered S. 1376, entitled 'FHA Solvency Act of 2013,' a bill to improve the Federal Housing Administration and to ensure the solvency of the Mutual Mortgage Insurance Fund, and for other purposes. The Committee voted to report the bill, as amended, to the Senate.

BACKGROUND

The Federal Housing Administration was established by the National Housing Act of 1934 as a response to the rapidly declining housing market during the Great Depression. It provides pooled mortgage insurance for loans made by FHA-approved lenders throughout the United States and its territories. In providing access to affordable mortgage credit, FHA plays a countercyclical role in the housing market by expanding when private capital is out of reach and contracting when private capital is willing to offer borrowers affordable terms. FHA also plays a crucial role in providing access to credit for first-time homebuyers and middle income families during all economic conditions. FHA pays claims on insured single-family loans, and since Fiscal Year (FY) 2009, Home Equity Conversion Mortgages (HECMs) and condominium loans through its Mutual Mortgage Insurance Fund (MMI Fund). The MMI Fund is required to be self-supporting, using premiums and other fees it earns on insured loans to pay for claims and other costs related to those loans rather than appropriations.

Beginning in 2007, as lenders and private mortgage insurers began pulling back from the housing market, FHA dramatically increased its market share to fulfill its countercyclical role to stabilize credit markets in times of economic disruption. Hearing witnesses cited an estimate that the recent housing crisis would have been exacerbated without FHA, as home values would have fallen an additional 25 percent and 3 million more jobs would have been lost.¹

¹ *Addressing FHA's Financial Condition and Program Challenges, Part II: Hearing Before the Committee on Banking, Housing, and Urban Affairs, United States Senate, 113th Cong. (2013)* (written testimony of Gary Thomas, President, National Association of Realtors and Sarah Rosen Wartell, President, Urban Institute); *Oversight of FHA: Examining HUD's Response to Fiscal Challenges: Hearing Before the Committee on Banking, Housing,*

As a result of the housing crisis and the corresponding increase in FHA's portfolio, default rates rose, particularly on loans originated during the 2007-2009 time period, and on loans guaranteed through the HECM program. The rise in default rates led to an increase in FHA's actual and expected losses, requiring FHA to use its capital reserves to pay for claims on the MMI Fund, which in turn reduced FHA's capital reserve ratio below the two percent level required by statute. This decline started in FY 2006, leading to a negative 1.44 percent ratio in FY 2012. During this time, FHA took actions to reduce the severity of their losses on defaulting loans and raised insurance premiums. These actions and an improving economy over the past year boosted the capital reserve ratio levels. However, based on data in the FY 2013 independent actuarial report, FHA reported its capital reserve ratio remains negative but is projected to achieve the mandatory two percent in FY 2015.

PURPOSE OF THE LEGISLATION

The FHA Solvency Act of 2013 will strengthen and improve the Federal Housing Administration to protect the solvency of the Mutual Mortgage Insurance Fund. While FHA has taken steps in recent years to improve the safety and soundness of the program and tighten oversight of FHA approved lenders, additional authority was requested to ensure the solvency of the MMI Fund.

HEARINGS

On July 24, 2013, the full Committee held a hearing titled "The FHA Solvency Act of 2013," to discuss S. 1376. FHA Commissioner Carol J. Galante, Assistant Secretary of the U.S. Department of Housing and Urban Development, testified at the hearing.

On February 28, 2013, the Committee held a hearing entitled, "Addressing FHA's Financial Condition and Program Challenges, Part II." The hearing discussed actions FHA could take to mitigate losses to the MMI Fund. Witnesses were: Mr. Gary Thomas, President, National Association of Realtors; Mr. Peter Bell, President, National Reverse Mortgage Lenders Association; The Honorable Phillip L. Swagel, Professor in International Economic Policy at the Maryland School of Public Policy, University of Maryland; Ms. Sarah Rosen Wartell, President, Urban Institute; Ms. Teresa Bryce Bazemore, President, Radian Guaranty Incorporated; and The Honorable David H. Stevens, President and Chief Executive Officer, Mortgage Bankers Association.

On December 6, 2012, the Committee held a hearing entitled, "Examining HUD's Response to Fiscal Challenges." The witness was The Honorable Shaun Donovan, Secretary, U.S. Department of Housing and Urban Development. The hearing reviewed actions taken by HUD to improve the fiscal health of the MMI Fund as well as HUD requests for authority to take additional actions.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

and Urban Affairs, United States Senate, 112th Cong. (2012) (written testimony of The Honorable Shaun Donovan, Secretary, U.S. Department of Housing and Urban Development).

Section 1. Short title and table of contents.

Section 2. Mortgage insurance premiums.

This section amends section 203(c)(2) of the National Housing Act. This section would require the Secretary to charge a minimum annual mortgage insurance premium of at least 55 basis points. It also increases the annual premium cap by 50 basis points. This section also would require the Secretary to evaluate premium levels at least annually to ensure that the combined up-front and annual premiums for the life of a loan will cover the expected risk to the fund and maintain the mandated capital reserve ratio.

Section 3. Prohibition on insuring mortgagors with two prior foreclosures.

This section amends Section 203 of the National Housing Act to prohibit FHA insurance on mortgages if the borrower was foreclosed upon twice previously.

Section 4. Indemnification by FHA mortgagees.

This section gives the Secretary the authority to seek indemnification from mortgagees approved to originate loans under the lender insurance program or the direct endorsement program. Currently, the Secretary only has the authority to seek indemnification from mortgagees under the lender insurance program. To qualify for indemnification, the mortgage must have a material defect that would have prevented the loan from being insured or have involved fraud or misrepresentation. Except in cases of fraud or misrepresentation, the loan must have been delinquent within 36 months and resulted in a default. If the Secretary determines that the fraud or misrepresentation was committed by a third-party (not the mortgagee) and that the mortgagee had adequate quality control practices and review procedures to identify such fraud or misrepresentation, then the mortgagee will not be required to indemnify the Secretary. The Secretary is required to issue regulations regarding requirements for mortgagees, public reporting of loans subject to indemnification, and an appeals process.

Section 5. Review of mortgagee performance.

This section amends Section 533 of the National Housing Act to expand the criteria the Secretary uses to compare mortgagee performance. This section also provides the Secretary with the authority to terminate a mortgagee's approval on a national basis. Currently, a mortgagee's approval can only be terminated in a specific geographical area. The Secretary would also issue regulations to establish an appeals process for a termination decision.

Section 6. Transfer of mortgage servicing duties.

This section permits the Secretary to issue rules requiring an underperforming servicer to contract with a specialty subservicer for a single mortgage or any pool of mortgages. This section requires the following to be included in the rules: the performance conditions that would trigger the requirement to use a subservicer; a reasonable time period for the servicer to fix the problem

or problems before the subservicer is required (unless the delay would harm the MMI Fund); and the possibility of stricter penalties should the servicer have similar problems for a third time. The rules must also ensure the authority provided in this section only applies to activities that may materially and adversely affect the Secretary's ability to recover in the future and be limited to mortgages that share similar underwriting, borrower, and performance characteristics.

Section 7. Easing regulatory burdens; resource guide.

This section directs the Secretary to establish a single resource guide for lenders and servicers regarding the requirements, policies, processes, and procedures that apply to loans insured by FHA. This section also requires that the guide be made publicly available and posted on HUD's website.

Section 8. Improving underwriting standards.

This section directs the Secretary to evaluate and revise as necessary FHA's underwriting standards using criteria similar to the CFPB's criteria for Qualified Mortgages. Criteria which the Secretary must evaluate includes a borrower's income and financial resources, monthly mortgage payment, other debts, employment status (if employment income is included in financial resources), debt-to-income ratio, and credit history.

Section 9. Ensuring adequate capital levels in the Mutual Mortgage Insurance Fund.

This section amends section 205 of the National Housing Act to require that the MMI Fund achieve a capital reserve ratio of 3 percent within 10 years of enactment. It establishes escalating reporting requirements and program evaluations that take effect immediately if the capital ratio falls below required levels depending on how undercapitalized the fund is in comparison to the mandated capital reserve ratio. The fund shall be designated as undercapitalized in the event that the capital reserve ratio is less than 100 percent but not less than 50 percent of the ratio required by statute. The fund shall be designated as significantly undercapitalized in the event that the capital reserve ratio is less than 50 percent of the required ratio but not less than zero of the ratio required by statute. And finally, the fund shall be designated as critically undercapitalized in the event that the capital reserve ratio is negative. With each designation this section mandates escalating transparency requirements regarding the state of the fund. It also sets out a process for additional assessments of risk and additional premium surcharges as applicable. The 6-month process for imposing premium surcharges would apply if:

- 1) the MMI Fund is critically undercapitalized 2 years after enactment of the FHA Solvency Act and thereafter, as indicated in the actuarial report;
- 2) after submission of the FY2016 actuarial report, the MMI Fund has not achieved a 2 percent capital reserve ratio;
- 3) after the submission of the FY2016 actuarial report but prior to the earlier of 10 years after the date of enactment or the date the Fund achieves 3 percent, there is a decrease in the value of the ratio from one report to the next, as determined by the independent actuary, without a concurrent drop in market share;
- 4) the capital reserve ratio fails to achieve and maintain 3 percent by the date that is 10 years after enactment and thereafter, as indicated in the actuarial report.

Section 10. Stress testing of the Mutual Mortgage Insurance Fund.

This section amends Section 202 of the National Housing Act to require the Secretary's annual report on the independent actuary's study include an alternative stress test scenario, which the Secretary shall develop. The alternative stress test should be developed to help assess the financial status of the Mutual Mortgage Insurance Fund, and may rely on assumptions used by the Federal Reserve Board's Comprehensive Capital Analysis and Review (CCAR) stress tests, if those assumptions are relevant to the financial status of the MMI Fund. This section does not limit how many alternative stress test scenarios may be included. While any alternative stress test scenario should be utilized to support sound financial planning for the MMI Fund, the published results from these alternative scenarios should not be binding for purposes of the MMI Fund achieving mandatory capital reserve minimums.

Additionally, this section is not intended to restrain or otherwise alter how the Federal Reserve Board and other regulators design and administer stress tests, including those required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, for entities they regulate.

Section 11. Congressional notification of use of certain authorities with respect to the FHA.

This section requires the Secretary of the Treasury to notify the Committee on Banking, Housing, and Urban Affairs and the Committee on Financial Services within 48 hours of exercising its permanent, indefinite authority under 2 U.S.C. 661c(f) to fund re-estimates of the FHA's Mutual Mortgage Insurance Fund. The Secretary of HUD is also required to notify the same Committees within 48 hours of receiving funds pursuant to the permanent, indefinite authority to cover a downward re-estimate. Both notices must also be put on the websites of Treasury and HUD. Any report that the HUD Secretary is required to submit to Congress shall include the total amount that must be paid back to Treasury.

Section 12. Establishment of Deputy Assistant Secretary and Chief Risk Officer of FHA.

This section creates a Chief Risk Officer within the FHA and establishes the criteria for the position. It also requires the Officer to conduct an annual study of the lowest performing loans.

Section 13. Disclosure of events.

This section requires the disclosure of any event that occurs between the finalization the Annual Actuarial Report and the submission of the Annual Report to Congress that might affect the report's findings. This disclosure shall be released as an addendum to the Report to Congress with an accompanying letter serving as a summary.

Section 14. GAO study on disclosures.

This section would direct the GAO to examine HUD's disclosure of FHA data and to consult with prominent academics with housing market experience regarding the data that is disclosed. The GAO is asked to make recommendations regarding the data disclosed by the Secretary and

to conduct a follow-up study regarding implementation of the recommendations one year after the study is complete.

Section 15. Stabilizing the HECM program.

This section limits the Secretary's authority to change the HECM program by mortgagee letter to only those changes that involve escrow accounts or set-asides, financial assessments, or loan limits. Any such changes by mortgagee letter must be accompanied by a rulemaking. This will allow the Secretary to make changes quickly without eliminating the option for public comment. However, the Secretary's authority to use mortgagee letters to change the HECM program will expire two years after enactment of this section. This section also makes several statutory changes to the HECM program. The Secretary must: issue a rule eliminating the standard fixed-rate, full draw option and mandating a financial assessment of the mortgagor for any other fixed-rate full draw products; require an escrow or set-aside account if doing so would mitigate the risk of loss, given the mortgagor's financial situation; and submit quarterly reports on the financial status of each product offered under the HECM program to the Committee on Banking, Housing, and Urban Affairs and the Committee on Financial Services.

Section 16. Principal limit factor for HECM program.

This section amends Section 255 of the National Housing Act to tighten the principal limit on fixed rate home equity conversion mortgages.

Section 17. Publication of final rules relating to limiting seller contributions towards purchase related expenses.

This section directs HUD to finalize their proposed seller concessions rule.

Section 18. GAO study on FHA loan limits.

This section requires the GAO to conduct a one-time study on the principal loan limits for FHA-insured mortgages. The study requires GAO to make recommendations on the methodology to adjust the loan limits, taking into consideration inflation, geographic price differences, and countercyclical demands.

COST OF LEGISLATION

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

SUMMARY

S. 1376 would make several changes to current law aimed at improving the financial safety and soundness of the Federal Housing Administration's (FHA's) Mutual Mortgage Insurance (MMI) fund. That fund records the transactions of two housing programs operated by FHA: the single-family mortgage guarantee program and the Home Equity Conversion Mortgage (HECM) program. The bill would require FHA to take certain corrective actions if the annual actuarial

review of the MMI fund indicates that the fund's capital ratio has fallen below certain targets and would require FHA to make other administrative changes to the processes they use to oversee the single-family and HECM programs.

CBO estimates that implementing S. 1376 would result in a net decrease in discretionary spending of \$514 million over the 2014-2018 period, assuming enactment of appropriation laws necessary to implement the legislation's provisions. This legislation would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

S. 1376 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 1376 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Millions of Dollars					
	2014	2015	2016	2017	2018	2014-2018
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
FHA Insurance Premiums						
Estimated Authorization Level	0	0	0	0	-524	-524
Estimated Outlays	0	0	0	0	-524	-524
Other Costs						
Estimated Authorization Level	2	2	2	2	2	10
Estimated Outlays	2	2	2	2	2	10
Total Changes						
Estimated Authorization Level	2	2	2	2	-522	-514
Estimated Outlays	2	2	2	2	-522	-514

Note: FHA = Federal Housing Administration.

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted near the start of calendar year 2014 and that the necessary amounts will be appropriated each year.

FHA Insurance Premiums

Currently the MMI fund is required to maintain a 2 percent capital ratio. (The capital ratio measures FHA's cash on hand relative to the value of all outstanding mortgages insured by the agency.) Enacting this legislation would require FHA to evaluate the premiums it charges for mortgage insurance on an annual basis and the MMI fund to achieve a capital ratio of 3 percent within 10 years of enactment. The legislation also would establish additional reporting requirements and require program evaluations and programmatic changes if the fund doesn't meet certain targets as it builds towards the proposed 3 percent capital ratio over the next 10 years. For example, FHA would be required to impose a surcharge of 10 basis points on its guarantees if the actuarial report for fiscal year 2016 indicates that the capital ratio is less than 1.25 percent.

CBO estimates that under current law, FHA will charge borrowers insurance premiums sufficient to maintain a capital ratio that exceeds 1.25 percent in the next couple of years, so we expect that, under the bill, FHA would not impose the 10 basis point surcharge in 2016. However, under the bill, CBO expects that FHA would probably increase its initial and annual insurance premiums beginning in 2018 in order to achieve a 3 percent capital ratio in the MMI fund by 2023; such increases in premiums would result in an increase in offsetting collections totaling \$524 million in 2018 (and further increases in collections in subsequent years), assuming commitment authority to operate the single-family program is included in future appropriation acts.

Other Costs

Based on estimates of the cost of similar programmatic activities, CBO estimates that the additional reporting requirements and other administrative activities required to maintain adequate capital balances in the MMI fund would cost \$10 million over the 2014-2018 period, subject to the availability of appropriated funds.

Implementing S. 1376 would change various processes used by FHA to oversee the single-family and HECM programs. The bill would require FHA to:

- Issue regulations to establish a nationwide appeals process for terminating a borrower's approval;
- Issue regulations related to loans subject to indemnification; and
- Alter the management of the HECM program through letters to mortgagees and rulemaking procedures.

The Government Accountability Office also would be required to produce a report on the appropriate methodology for adjusting FHA's loan limits and a report examining FHA's procedures for disclosure of its housing program data.

PAY-AS-YOU-GO CONSIDERATIONS

None.

ESTIMATED INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 1376 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

ESTIMATE PREPARED BY:

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REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact of the bill.

This legislation will not have a substantial regulatory impact because it makes several changes to the administration of the Federal Housing Administration (FHA), its programs, and its authorities, but does not place requirements on businesses or individuals directly. Changes to FHA programs may affect the businesses or individuals who choose to participate in the FHA-insured mortgage market.

CHANGES IN EXISTING LAW (CORDON RULE)

On July 31, 2013, the Committee unanimously approved a motion by Senator Johnson to waive the Cordon rule. Thus, in the opinion of the Committee, it is necessary to dispense with section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.